NOTES

WASHINGTON NOTES

OPENING THE FEDERAL RESERVE BANKS

The events of the past month in national affairs have continued to be almost exclusively financial in their nature and significance, the adjournment of Congress having ended general legislation for the time, while international relations have almost necessarily concerned themselves in the first instance with the re-establishment of foreign trade and the restoration of sounder conditions of payment and exchange. Behind all these problems and affording the conditions upon which most solutions for them rested has stood the question of providing for and securing the opening of the new federal reserve banks. This was a subject control over which was placed, by the terms of the Federal Reserve act, exclusively in the hands of the Secretary of the Treasury, inasmuch as that officer was given power to announce when the new banks had been "established" and to order the readjustment of member banks' reserves upon the new footing provided by law. There was a difference of opinion regarding the best date for opening, but November 16 was finally settled upon by the Secretary of the Treasury, and there was general agreement that if possible the transfer of reserves to the new banks should be in actual cash.

Transferring reserves.—The Secretary of the Treasury having advised the Federal Reserve Board that formal notice of the establishment of the several federal reserve banks would be given to all member banks on November 16, it became necessary to make arrangements at once for the transfer of required reserves by the member banks to their respective federal reserve banks on that date. In an effort to bring about this actual physical transfer of the first instalment in such a manner as to produce the least possible disturbance of business conditions in any city or section, the Board sought to secure transfers of reserves without the use of rediscount facilities.

It was, of course, clear that if the banks in non-reserve cities should undertake to make the necessary deposit of reserves with their federal reserve bank by remitting checks or drafts on banks in reserve cities (which checks or drafts could be received by the federal reserve banks for collection only), there might result an unnecessarily heavy withdrawal of funds from the banks in reserve cities. In the same manner,

if banks in reserve cities should make remittances of checks or drafts on banks in central reserve cities, an unnecessary burden might be placed upon the latter. Hence a decision was announced that the deposits of reserves with federal reserve banks must be made in gold or lawful money, and in order that the withdrawal of funds from the vaults of member banks might be as nearly uniform as possible, and so distributed as to relieve any particular section or sections of unnecessary burden, the Board requested all banks to ship from their own vaults gold or lawful money. The federal reserve banks were authorized, by a circular issued on October 28, to assume and pay the express charges involved in making such shipments and also the payments on account of the first instalment of capital stock due November 2.

In view of the advantage to be derived from the deposits of gold, which might be used as reserve for federal reserve notes, the Board moreover strongly urged that deposits of reserves in the federal reserve banks be made, so far as practicable, in gold or gold certificates. Due notice of the establishment of the federal reserve banks on November 16 was sent each member bank by the Secretary of the Treasury, since no transfer of reserve could be made until such action had been taken. Member banks of large resources were asked to facilitate the physical work of counting reserve money by sending gold certificates in as large denominations as possible or clearing-house orders calling for gold certificates or gold already counted by the clearing-houses. The Board therefore appealed to the patriotic spirit of all member banks in urging them to do their utmost in facilitating the work thrown upon the officers of the newly created reserve banks, and so to help secure for the new system the greatest possible success from the beginning.

The tabulation on p. 1008 gives the facts in regard to the size and capitalization of the reserve banks at the opening of the system. The gross reserve deposits of the system as a whole, under the instructions given, totaled some $250,000,000, of which much more than $150,000,000 was paid in actual gold or its equivalent.

Defining commercial paper.—In order to enable the new banks to open successfully it was necessary to determine a discount policy. The directors and governors of the federal reserve banks, at a conference in Washington on October 20 and 21, had recommended that the banks be opened without attempting at the outset to perform all the functions and duties contemplated in the act, but that they be prepared to accept deposits of reserves payable in lawful money, to discount bills of exchange and commercial paper, and to accept the deposit (after the reserve

Dist.	Location of Reserve Banks	Capital (Authorized)	Area in Square Miles	Population	No. Member Banks	Territory Covered
1	Boston	$ 9,711,900	66,465	6,557,841	441	Me., N.H., Vt., Mass., R.I., Conn.
2	New York	19,931,700	49,170	9,113,279	480	New York State.
3	Philadelphia	12,501,500	39,865	8,110,217	758	N.J., Del., eastern Pa.
4	Cleveland	12,101,700	183,995	7,961,022	764	Ohio, western Pa., northwestern W.Va., eastern Ky.
5	Richmond	6,387,400	173,818	8,519,313	496	D.C., Md., Va., N.C., S.C., remainder W.Va.
6	Atlanta	4,670,600	233,860	6,695,341	381	Ala., Ga., Fla., eastern Tenn., southern Miss., southeastern La.
7	Chicago	12,687,700	176,940	12,630,383	971	Ia., southern Wis., Mich. (except peninsula), northern Ill., northern Ind.
8	St. Louis	4,987,500	146,474	6,726,611	459	Ark., all Mo. (except extreme west), southern Ill., southern Ind., western Ky., western Tenn., northern Miss.
9	Minneapolis	4,811,000	437,930	5,724,895	709	Mont., N.D., S.D., Minn., northern Wis., Mich. peninsula.
10	Kansas City	5,530,300	509,649	6,306,850	837	Kans., Nebr., Colo., Wyo., extreme western Mo., northern Okla., extreme northern N.M.
11	Dallas	5,698,900	404,826	5,310,561	754	Tex., remainder N.M., southern Okla., remainder La., southeastern Ariz.
12	San Francisco	7,775,400	693,658	5,389,303	521	Cal., Wash., Ore., Idaho, Nev., Utah, remainder Ariz.
	Totals	$106,795,600	3,116,650	89,045,616	7,571	

payments had been made) of checks drawn by member banks on any federal reserve bank or member banks in the reserve and central reserve cities within their respective districts. The Board after reviewing the work of this conference outlined on November 11 the general discount situation as follows (Board's Circular No. 13):

It should be borne in mind that, although our European exports are showing a gratifying increase, there is still a large cash balance due to European countries for which gold may be demanded, and that a large quantity of European securities held abroad may be returned to the United States; while on the other hand more than $300,000,000 of emergency currency must be gradually retired. No one can estimate the duration of the war or predict what will be the financial and commercial conditions when peace shall be restored. Our own industrial development has been greatly facilitated by foreign capital, and we have been accustomed to borrow large sums annually in Europe and to sell American securities there, which attracted foreigners because of the higher rate of return as compared with European investments. It is probable that at the end of the war interest rates in Europe will be higher than they have been in the past and greater investment returns will be yielded. The tremendous destruction of property and waste of capital will not only check the flow of European savings to the United States, but may dispose foreign investors to return us the securities they now hold. Lower rates in this country would be likely to accentuate this tendency, while, on the other hand, higher rates and larger investment returns on our side would check it.

The Board further prescribed the following basic principles for the guidance of federal reserve banks and member banks:

a) No bill shall be admitted to rediscount by federal reserve banks the proceeds of which have been or are to be applied to permanent investment.

b) Maturities of discounted bills should be well distributed. It is the well-established practice of European reserve banks to invest only in obligations maturing within a short time. It is a general rule not to purchase paper having more than 90 days to run. The maturities of these notes and bills are so well distributed as to enable those banks within a short time to strengthen their hold on the general money market by collecting at maturity or by reinvesting at a higher rate a very substantial proportion of their assets.

c) Bills should be essentially self-liquidating.

Safety requires not only that bills held by federal reserve banks should be of short and well-distributed maturities, but, in addition, should be of such character that it is reasonably certain that they can be collected when they mature. They ought to be essentially "self-liquidating" or, in other words, should represent in every case some distinct step or stage in the productive or distributive process—the progression of goods from producer to consumer. The more nearly these steps approach the final consumer the smaller will be

the amount involved in each transaction as represented by the bill, and the more automatically self-liquidating will be its character.

Double-name paper drawn on a purchaser against an actual sale of goods affords, from the economic point of view, prima facie evidence of the character of the transaction from which it arose. Single-name notes, now so freely used in the United States, may represent the same kind of transaction as those bearing two names. Inasmuch, however, as the single-name paper does not show on its face the character of the transaction out of which it arose—an admitted weakness of this form of paper—it is incumbent upon each federal reserve bank to insist that the character of the business and the general status of the concerns applying for such paper should be carefully examined in order that the discounting bank may be certain that no such single-name paper has been issued for the purchases excluded by the act, such as investments of a permanent or speculative nature. Only careful inquiry on these points will render it safe and proper for a federal reserve bank to consider such paper a "self-liquidating" investment at maturity.

The first rates of discount.—A final step remained to be taken by establishing rediscount rates, and consequently the governor of the Board announced on Saturday, November 14, that by action of the Board rates of rediscount had been established as follows: New York and Philadelphia, $5\frac{1}{2}$ per cent for bills and notes having a maturity of not over 30 days, and 6 per cent for paper with a longer maturity; Boston, Cleveland, Richmond, Chicago, and St. Louis, 6 per cent for all maturities; Atlanta, Minneapolis, Kansas City, Dallas, and San Francisco, 6 per cent for bills and notes having a maturity of not more than 30 days, and $6\frac{1}{2}$ per cent for those having a longer maturity.

The Board took this action in accordance with the provisions of the Federal Reserve act which authorized it to review and determine rates of discount fixed by each federal reserve bank. Each of the banks was requested by telegraph to suggest a rate of discount for opening and all of these replies were tabulated. The answers showed a very decided degree of uniformity, and many of the rates suggested by the various banks were confirmed, the lowest suggested rate being 5 per cent, while the highest was 7 per cent.

After full consideration of the facts in the situation, the Board announced that it felt under obligations to adopt a moderate and conservative policy at the outset in view of the fact that the exact conditions to which the banks would be subjected in operation could not be precisely foretold. It was felt that the adoption of rates of rediscount which would adequately safeguard the resources of the various institutions would be the wisest policy at the beginning, particularly in view

of the conditions already set forth in the Board's Circular No. 13. Under the terms of the Federal Reserve act the federal reserve banks have the right, with the approval of the Board, at any time to change the rates, and the rates thus fixed for the opening were, therefore, to be regarded as provisional and subject to revision. The Board at the same time stated that it expected to be governed entirely by experience as the new banks become firmly established and as they accumulate data which can be used for guidance in the future.

THE COTTON LOAN FUND

The completion of the cotton loan fund was announced on November 17, when subscriptions for the entire $100,000,000 of Class A certificates originally authorized were completed. To such extent as banks in the southern states subscribe to Class B certificates, the $100,000,000 realized from the the Class A certificates will be available for loans on cotton at a valuation of six cents per pound. The full amount of subscriptions to Class A certificates made by banks in non-cotton states amounts to $97,392,000 and the success of the plan was conditioned upon the subscription of the full $100,000,000 of these certificates. In order to make up the deficiency of $3,000,000, private bankers in New York subscribed the required amount.

The following is a list of the cities and the amounts subscribed to the fund:

New York City	$ 50,000,000
Baltimore	2,500,000
Boston	2,085,000
Chicago	13,000,000
Detroit	1,082,000
Cincinnati	2,000,000
Cleveland	2,000,000
Kansas City	2,000,000
Louisville	1,000,000
Minneapolis	1,000,000
Philadelphia	4,640,000
Pittsburgh	2,000,000
Richmond	1,125,000
St. Louis	11,500,000
San Francisco	360,000
Washington	1,000,000
	$ 97,292,000
Private bankers in New York	3,000,000
	$100,292,000

The success of this plan was for a time in doubt, its completion being delayed by the opposition of textile manufacturers and local interests which tried to defeat it. The project is intended to be beneficial, not only in maintaining the price of cotton and in helping foreign exchange, but also in promoting the general prosperity of the country. The fund becomes available practically simultaneously with the reopening of the cotton exchanges on November 16 after a suspension of fourteen weeks.

ADJUSTING INTERNATIONAL INDEBTEDNESS

An episode of special interest to students of international trade and foreign exchange has been afforded in the visit of Sir George Paish and Mr. Basil B. Blackett, representing the government of Great Britain, at the invitation of the government of the United States, extended through the Treasury Department. Some weeks ago there seemed to be reason to believe that the United States was in danger of being largely drained of its gold, as a result of the suspension of foreign business and particularly of cotton exports. Some selling of securities has been steadily going on for foreign account even since the closing of the New York stock exchange, while the indebtedness of the past spring and summer, usually liquidated by the shipment of cotton and grain, was still awaiting payment, with English concerns relieved of the necessity of paying their own debts through the establishment of the so-called "moratorium." Had this state of things continued for any considerable period it would have been necessary for New York and other bankers to continue the practical suspension of gold payments they had already initiated, or else to see their gold slowly withdrawn to meet foreign obligations. One of the first evidences of nervousness was the placing of a huge loan, intended to relieve the city of New York of embarrassment with regard to its outstanding foreign indebtedness, this loan being taken by New York City banks at an unusually high rate of interest and commission. The prevailing anxiety was further illustrated by the invitation extended to the British delegates, as just described, their confessed purpose in visiting this country being that of arranging some means of relieving debtors in the United States from the necessity of paying foreign debts in gold immediately. As soon as the two delegates reached the United States a conference between them and the Federal Reserve Board and a committee of bankers from several cities was arranged, to secure first of all an interchange of ideas as to possibilities of amelioration. It is an interesting fact that, although there

had been little delay on the part of the British delegates in taking their departure from England, the conditions had already improved so much, prior to the conference, that the American bankers present, in not a few cases, were distinctly lacking in eagerness to get fresh aid; at the same time Sir George Paish and his associate were strong in their statements that there was no apparent reason to look for an exceptional or dangerous drain of gold from the United States. Announcements to this effect, officially made, served still further to allay popular fears as to the international exchange situation. The discussion of possible means of alleviating any difficulties that might exist was referred to a special committee representing the bankers and the Reserve Board, but before any report could be presented by this committee the announcement came from the Treasury Department, on November 21, that the British government had already recalled its representatives for further conference and instructions. A study of recent foreign trade figures gives the real clue to the situation, as it shows that during the period of negotiation the international balance of the United States has almost reversed itself. Large orders for war material, food, grain, and other staples, together with some revival of foreign business in cotton, have effectually turned the tide. Instead of a debt of some $200,000,000 on current account—the estimated extent of American liabilities at the time of the arrival of the British representatives—it is now likely that, taking the goods already shipped together with the orders lately placed and in process of manufacture, there is a small net balance in favor of the United States. This outcome has been aided by the almost total suspension of American tourist travel abroad and the curtailment of importations from the warring countries into the United States. Thus ends one more effort to modify, by government agreement or interference of some variety, the general course of international business. The real problem in the relations between the United States and Great Britain, as well as between the United States and other countries, of course still remains open and will not be relieved by any amount of negotiation. The underlying question is: To what extent will these countries call upon the United States for assistance in the repurchase of American securities by offering such securities at prices so favorable that investors in this country will be inevitably attracted by them and will buy them, thereby necessitating the exportation of a corresponding amount of fluid capital in payment? The question is one that can be answered only after more experience and after further demonstration of the effects of the war.

OBSCURING THE TARIFF ISSUE

Meantime, it is a distinctly interesting situation in international trade that has already resulted from the European war. For all practical purposes the condition is that which would be produced by a prohibitive tariff. There is gradually developing some restoration of a normal state of things, inasmuch as importations are slowly increasing, but the stimulus given to exportation by war necessities abroad, and by the new opportunities in various fields of export trade formerly occupied by foreigners, has resulted in the always-desired "favorable balance of trade." In practice, this "favorable balance" will result merely in enabling the United States to buy back again at low prices some of the securities which have been sold to Europeans in past years, and to pay for them at substantially our own rates with goods currently manufactured. From the standpoint of tariff legislation, however, the outcome is regrettable. Not enough time had been given prior to the end of July, 1914, when the war broke out, to afford any real test of the working of the Underwood tariff of 1913, either as a revenue-producer or as a "protective" measure. It seems hardly likely at the present moment that there will be an end to the war in time to permit a further test, free of exceptionally troubled conditions, prior to the date of the next elections. Thus the tariff discussion is again obscured, and a rational conclusion with respect to it is rendered almost out of the question. The outcome at the polls on November 3 is currently attributed to dissatisfaction with the tariff and its effects, and was no doubt in part the result of unemployment and consequent restlessness on the part of the wage-earning classes of the community. Efforts to amend the tariff are already being planned, so that it would seem that another period of discussion of that subject is about to open. This prospect is the more disappointing because it comes at a time when it had been reasonably expected that there would be full and ample opportunity, such as had never before been furnished, for a thorough test of the real tariff situation, with data adequate to indicate the true influence of lower duties. To those who protest that the current experience is no test of the working of the new duties under the act of 1913 it is being plausibly answered that the war in Europe is equivalent to the restoration of protection, and that in consequence no sound inferences can be drawn. Thus, much of what was gained by the tariff debate of eighteen months ago bids fair to be almost completely lost.